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STATE FOR EUR/RUS; NSC FOR JELLISON

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TAGS: [ECON](#) [EINV](#) [ETRD](#) [PREL](#) [PGOV](#) [RS](#)
SUBJECT: IEEPA SANCTIONS: POSSIBLE RUSSIAN RESPONSES

REF: A.) MOSCOW 2602 B.) MOSCOW 2615

Classified By: Ambassador John R. Beyrle for Reasons 1.5 (b) and (d).

Overview

¶1. (C) At a meeting with Russian businessmen September 15, President Medvedev said any Western sanctions would be met with a "symmetrical" response. U.S. sanctions, even targeted IEEPA sanctions, are likely to be met with Russian counter-measures. There are indications, here at least, that the Europeans may not go along with even targeted sanctions. If U.S. sanctions are unilateral, then it will be exclusively U.S. companies that suffer from Russian retaliation.

¶2. (C) Medvedev has also urged Russian businesses to invest in Abkhazia and South Ossetia. Many are likely to see it as their patriotic duty to do so; others will invest as the price of staying on the GOR's good side. U.S. sanctions will certainly complicate these companies' decision-making. However, in the final analysis, most are likely to conclude that they need the GOR's goodwill more and will go forward with investments. In addition to risking damage to U.S. commercial interests in Russia, targeted sanctions may therefore also prove ineffective.

Potential U.S. Targets

¶3. (C) American business interests in Russia have been growing rapidly in recent years as the Russian economy has expanded. According to Department of Commerce statistics, trade grew at a rate of 56 percent in 2007 and 47 percent through the first half of 2008. Investment has also been growing rapidly and totaled roughly \$16 billion in direct investment at the end of 2007. Although the absolute numbers are not large they include a who's who of American companies. The GOR could focus its counter measures on any of these companies, but we would highlight the following as the most likely targets:

-- As we noted in reftel A, the Boeing contract with Aeroflot would be a tempting target. First, it's a large contract, worth \$3.6 billion for 22 aircraft. Second, the GOR could award the contract instead to Airbus, driving a wedge between the U.S. and the EU. In addition to Aeroflot, the Russian air transport company Volga-Dnepr is also seeking to buy five aircraft from Boeing.

-- General Electric, which manufactures \$50 million in engines for each Boeing aircraft, would also be hurt by canceled orders. GE's business in the energy sector could

also be at risk. Total Russian orders for GE gas turbines were \$700 million this year, and GE estimates they will be over one \$1 billion in 2009. GE's European and Japanese competitors, Siemens and Mitsubishi, would stand to profit from a GOR decision to pull these contracts.

-- Another potentially high-profile target would be ExxonMobil, which has \$5 billion invested in Sakhalin 1. ExxonMobil operates the project, which includes Rosneft, and Japanese and Indian companies. The consortium has been at loggerheads with Gazprom and the GOR over selling gas directly to China and ExxonMobil could be forced to sell to Gazprom. An even more serious problem would be actions such as tax audits, environmental suits and labor law investigations (as with Yukos and TNK-BP) designed to drive ExxonMobil out of the project in favor of Russian companies.

-- ExxonMobil and Chevron also have hundreds of millions of dollars invested in the Caspian Pipeline Consortium (CPC). CPC's expansion, on the verge of approval after a decade of negotiations, is important for development of both the Tengiz and Kashagan fields in Kazakhstan (in which Chevron and ExxonMobil are major players). Expansion could be further delayed by the GOR or the entire project could be effectively nationalized by the GOR, which is a part-owner of the pipeline.

-- The Russians could also withhold or delay registrations and licenses for approved U.S. investments. High profile examples include GM and Ford's planned expansions. Both companies' Russia operations are also dependent on tax breaks for profitability -- these could be withdrawn while competitors such as BMW are allowed to keep their tax benefits.

-- Another flagship U.S. investment is John Deere. Russian orders processed with EXIMBANK guarantees amount to \$135 million this year, and the company estimates that figure will increase to \$200 million in 2009. The GOR, pushed by the Agriculture Ministry, has already been exploring increased tariffs to protect domestic competitors and could accelerate these measures.

-- Other high profile U.S. companies that could be targeted include Microsoft, which had \$1 billion in computer/software sales this year, and Caterpillar, which is exporting about \$1 billion in agricultural and heavy machinery.

-- Finally, U.S. services in general, including insurance, banking, legal consulting, and accounting firms, with contracts totaling in the tens of millions of dollars, are extremely vulnerable to GOR retaliation. PriceWaterhouseCooper (PWC), for instance, has been embroiled in a dispute with the GOR over internal reimbursements for technical assistance from other PWC offices and internal payments for the use in Russia of company patents; the potential fines total \$14 million. The GOR has yet to accept international accounting standards in this area. It could easily initiate investigations of many U.S. companies on these grounds -- while deliberately exempting other foreign companies.

Consular Responses

14. (C) We understand that Washington is also considering visa restrictions. Visa restrictions on Russian businessmen, and South Ossetian or Abkhaz officials, would likely trigger one or more of the following:

-- Further Federal Migration Service delays, denials of work permit applications submitted by American businessmen, missionaries, professionals resident in Russia (approximately 10,000) 15,000 total).

-- More restrictive visa issuance policies by the MFA for American tourists, businessmen, students, and exchange

scholars (approximately 145,000 annually).

-- Increased border guard harassment of American citizens arriving at or departing from ports of entry (to include increased detentions on trumped up charges).

-- Reduced GOR cooperation in notification of American citizen arrests, and death cases.

-- Delays in processing of official USG visa applications.

-- Additional bureaucratic delays for, and hostile judicial treatment of, prospective American adoptive parents (in 2007, there were over 2,000).

-- Revocation of the accreditation of U.S.-based adoption service providers that assist American adoptive parents in Russia (currently 39 are accredited).

Comment

15. (C) Part of the Russian calculus, correct or not, is that it has the upper hand in trade or investment-related disputes. The world needs its commodities and therefore, they conclude, they will always be able to find a buyer for their oil, gas and minerals, regardless of any sanctions. This gives also them confidence that they will be able to prevent the Europeans or other large trading partners from going along with even targeted sanctions, such as IEEPA sanctions. The GOR knows that Russia will pay a price if unilateral U.S. sanctions are imposed but -- judging from Medvedev's comments on September 15, and our own informal soundings with business officials here -- they appear to believe that we will pay a greater price.
BEYRLE